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Siew Fan Wong

Universiti Tunku Abdul Rahman

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BRINGING IT BACK HOME: DEVELOPING CAPACITY FOR CHANGE

General Topics

Siew Fan Wong

Faculty of Information and Communication Technology

Universiti Tunku Abdul Rahman

Malaysia

wongsf@mail.utar.edu.my

Abstract

IT outsourcing is a common means of meeting internal organizational IT needs today. Gartner Dataquest estimated that worldwide IT outsourcing will grow to \$255 billion in 2008. Perhaps surprisingly, given its popularity, IT outsourcing has a high failure rate. When outsourcing relationships fail, organizations are forced to make costly changes to their sourcing strategy. One strategy is to bring the outsourced IT components back into the organizations and rebuild the entire IT department. The challenge is, how should organizations reabsorb these outsourced IT components to build the internal IT department? What types of capabilities do organizations need to develop or acquire to ensure a successful backsourcing process? This paper focuses on addressing the issue of IT backsourcing following a failed outsourcing relationship. It aims at explaining how organizations develop and acquire 'capacity for change' to facilitate the backsourcing process. The value of the study lies in the identification of useful strategies that facilitate the development of 'capacity for change'. These strategies serve as best practices for future backsourcing efforts.

Keywords: Backsourcing, outsourcing, restructuring, capacity for change

Introduction

Picture the following scenario. The outsourcing contract is signed. Operations are being transferred to the vendor, assets have been sold or disposed of, and employees have either left or been transitioned to the vendor. Essentially the organization has handed over the ownership of the people as well as the infrastructure used to manage and run day-to-day information technology (IT) operations. The organization is sitting down, waiting for miracle – that outsourcing will be the silver bullet that fixes the once “poor internal IT department” – to arrive. Then something unanticipated happens. The vendor fails to deliver the promised cost saving; performance expectation is not materialized; changes in the business environment deem the outsourcing contract irrelevant. The organization now feels extremely vulnerable, planning for next move. Although this is an unpleasant and dreaded scenario, one that neither party wants to think off in the pre-contractual phase, it is a common one.

DiamondCluster International found that 47% of those taking part in its annual Global IT Outsourcing survey reported that they had “abnormally terminated” an outsourcing firm or canceled a contract in 2005 (Thibodeau 2006). This is a sharp increase from the 21% who terminated outsourcing contracts in 2004 (Thibodeau 2006). Deloitte Consulting found that 25% of outsourcing deals failed to meet expectations in the first two years; a further 25% failed within the next five years (Vernon 2002). Similarly, DiamondCluster International (2003) reported that none of the executives it surveyed were fully satisfied with their outsourcing efforts; only 23% were more than partially satisfied, 54% were only partially satisfied, and about 23% were dissatisfied with their outsourcing relationships. Cutting Edge Information Inc. reported that up to 40% of organizations were discontented with their

outsourcing relationships (Malhotra 2002), while Gartner Dataquest Report claimed that about one of every three outsourcing contracts targeting cost reductions failed to meet expectations (Caldwell 2002).

When an outsourcing relationship fails, some organizations choose to undergo the expense of canceling the contracts and rebuilding in-house IT capabilities (Buxbaum 2002). This phenomenon, of bringing the once outsourced IT components back in-house, is called back sourcing (Hirschheim and Lacity 1998; Lacity and Willcocks 2000). Farmers Group, for example, paid \$4 million in cancellation fees and early termination penalties to extricate itself from its contract with Integrated Systems Solutions¹ (Overby 2003a). Similarly, Chase Manhattan Bank paid Fiserv \$15 million to terminate its outsourcing contract (Lacity and Willcocks 2001). Oxford Health canceled a five-year, \$270-\$330 million outsourcing deal with Computer Sciences Corporation less than two years into the arrangement to rebuild internal IT capabilities (Rosencrance 2002). Bank One hired more than 600 IT employees in an effort to shift away from its outsourcing strategy (Mearian 2001). Other companies that took the same route of internalizing their once outsourced IT components include Nissan North America Inc. (Thibodeau 2006), McDermott International Inc. (Rosencrance 2001), Ford Motor Co. (Eisenstein 2003), Sears, Roebuck and Co. (Thibodeau 2006), Washington Mutual (Overby 2003a), Metropolitan Pier and Exposition Authority (Overby 2003a), Farmers Group (Overby 2003a), JP Morgan Chase (Thibodeau 2006), Allstate Insurance (Melymuka 2003), Allied Office Products (Overby 2003b), and ABB Power (Hoffman 1993).

Even though a costly termination penalty is a great concern, the more significant and enormous task lies ahead. How should organizations reabsorb the outsourced IT components to build the internal IT department? What types of capabilities do organizations need to develop or acquire to ensure a successful restructuring process? This paper intends to examine these issues of IT back sourcing following a failed outsourcing relationship. It focuses on how organizations develop and acquire the 'capacity for change'. While the 'capacity for change' has been recognized as a crucial force in enabling the execution and accomplishment of change plan in organizations (Clark 1997; Fombrun 1992; Greenwood and Hinings 1996; Lewin 1951; Orlikowski and Hofman 1997; Tsoukas and Chia 2002), it is particularly valuable for back sourcing research because it helps to identify important but perhaps overlooked capabilities that facilitate the accomplishment of a back sourcing plan. More specifically, it underscores the value of developing the 'capacity for change' that suggests how organizations can be successful in their back sourcing efforts. Strategies identified by the case study presented might then serve as exemplary practices for future back sourcing efforts. The implications derived could thus contribute to the existing sourcing research through the examination of an important area that has not been widely addressed.

The paper is organized as follows. First it reviews literature related to the concept of 'capacity for change'. Then the choice of methodology for collecting and analyzing the data is described followed by a brief background of the case. After that, analysis of the data is presented. Finally, conclusions as well as contributions this paper makes are discussed.

Capacity for Change

Change is the shifting of one state to another. At the business-strategy level, for example, an organization could change from being a defender to being a prospector. Similarly, an organization could shift their focus from a manufacturing orientation to a service orientation. At the IT sourcing strategy level, organizations could move from outsourcing to back sourcing. These strategic changes are often triggered by the dynamic nature of internal as well as external environment that continuously undergo transitions and transformations (Rajagopalan and Spreitzer 1996). Among the factors that motivate organizational change are newly emerging conditions and needs, restructuring of management, and the lack of success with existing strategies (Rajagopalan and Spreitzer 1996; Van De Ven and Poole 1995).

Change has been categorized into different types: anticipated and unanticipated (Mintzberg 1987); anticipated, emergent, and opportunity-based (Orlikowski and Hofman 1997); and evolutionary and revolutionary (Gersick 1991). Regardless of the type of change, the literature converges on the importance of having the ability to develop, manage, and implement appropriate plans (Clark 1997; Fombrun 1992; Greenwood and Hinings 1996; Lewin 1951; Orlikowski and Hofman 1997). Such ability is crucial to the execution and accomplishment of the plan to change in organizations (Clark 1997; Fombrun 1992; Greenwood and Hinings 1996; Lewin 1951; Orlikowski and Hofman

¹ Integrated Systems Solutions is a division of IBM that eventually becomes the core of IBM Global Services.

1997; Tsoukas and Chia 2002) as it acts as the enabling dynamics that facilitate the change process (Greenwood and Hinings 1996; Tsoukas and Chia 2002). Greenwood and Hinings (1996) call this ability the 'capacity for action', while White and Linden (2002) term it the 'capacity to adapt'. In this study, the term 'capacity for change' will be used to identify this ability.

The 'capacity for change' includes three aspects (Greenwood and Hinings 1996):

1. Having sufficient understanding of the new conceptual destination.

This first aspect requires organizations to know and comprehend what the final goal is and how the "final destination" would look like. In back sourcing, this requires understanding the value, implications, suitability, and viability of the strategy to the organization. Similar to any other strategic decisions in organizations (Armstrong and Sambamurthy 1999; Boeker 1997; Hitt and Tyler 1991), a back sourcing-related change is often initiated by top management. This means executives shoulder the responsibility for understanding where their organization is heading and if an in-house sourcing model will support the attainment of the organizational goal; how an in-house sourcing model will function; and whether it is valuable and viable to adopt the model. Answers to these questions and the decisions that follow are shaped by executives' experiences, knowledge, philosophies, and beliefs (Armstrong and Sambamurthy 1999; Boeker 1997; Hitt and Tyler 1991). If executives believe in an internal sourcing model, they can envision how the model fits into their organizations. If the existing outsourcing strategy does not fit into their philosophies, they will initiate the effort to bring the outsourced IT activities back into the organization. Executives' vision and understanding of where they are heading and how the back sourcing model will function in their organization is crucial, because such understanding motivates, shapes, and guides the entire back sourcing effort.

2. Having the ability to manage how to get to that destination.

This aspect points to the need to have the ability to successfully transition the outsourced IT component back into the organization. Terminating an outsourcing arrangement to move toward back sourcing has a more draconian consequence than simply contract renegotiation or switching vendors. A severed outsourcing relationship may influence service continuity and force organizations into operational disarray. Unanticipated changes may arise to disrupt the transitioning process. Furthermore, due to the pervasiveness of IT in organizations today, a change in IT sourcing will impact not only the IT department but also other functional units as well as the entire organization. In addition, it is difficult to promote a back sourcing plan considering the negative perception top management and business units commonly held toward IT prior to outsourcing (Chapman and Andrade 1998). The scope of a back sourcing-related change management is therefore complex and challenging. To be successful, organizations have to address both anticipated and unanticipated challenges that might disrupt the transitioning process (Clark 1997; Orlikowski and Hofman 1997).

3. Having the resources, skills, and competencies required to function in that new destination.

This aspect relates to the availability of the necessary skills and capabilities to perform efficiently and effectively when the back sourcing plan is completed. Acquiring the necessary skills and capabilities are challenging, because outsourcing arrangements often involve the transfer of physical and human assets to vendors that leave organizations with minimum or zero capabilities (Buxbaum 2002; Chapman and Andrade 1998). This is especially true in the case of total back sourcing that entails the rebuilding of the entire IT department. In this case, organizations find themselves lacking the resources and capabilities to ensure service continuity and to function in the post-back sourcing period (Buxbaum 2002; Chapman and Andrade 1998). The task to recruit IT employees, procure IT assets, and reposition the IT department to function at an optimal level is also enormous and challenging (Chapman and Andrade 1998). Therefore, one of the challenging tasks to ensure the accomplishment of a back sourcing plan is to make sure that the organizations have the capabilities to operate IT activities that are transferred back into them.

Essentially the 'capacity for change' embraces both the necessary skills and resources within an organization as well as their mobilization (Greenwood and Hinings 1996). These necessary skills and resources incorporate physical resources, human resources (and their knowledge and acceptance of potential changes), and organizational capital resources (Barney 1991). Mobilization is the act of leaderships to employ and manage the skills and resources so that the organization will attain its goals (Greenwood and Hinings 1996). The development of the 'capacity for

change' is essential and valuable to the successful implementation of a back sourcing plan. It determines how organizations craft an effective tactical strategy detailing what the newly back sourced IT department will look like and how it will function (Chapman and Andrade 1998). It also shows how organizations manage both anticipated and unanticipated changes.

While Greenwood and Hinings (1996) introduce the concept of 'capacity for change' in an institutional context, this context might not be directly applicable to either outsourcing or back sourcing. In fact, unlike some accounting or financial practices, outsourcing has not been rooted deeply into an institutional context that will dictate its practices. The importance of the concept 'capacity for change', however, has been highlighted in the literature either directly or indirectly (Clark 1997; Fombrun 1992; Greenwood and Hinings 1996; Lewin 1951; Orlikowski and Hofman 1997; Tsoukas and Chia 2002) in both institutional and non-institutional contexts. It is the intention of this paper to apply the concept to examine how organizations develop the 'capacity for change' in their effort to bring the outsourced IT function back into the organizations.

Methodology

A case study methodology is chosen for the investigation of the research question. This method is preferred "when 'how' or 'why' questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context" (Yin 1994, p. 16). A case study method is also suitable for exploratory study where little is known about the phenomenon and where in-depth analysis can be conducted to gain new insights (Lee 1989; Yin 1994). The investigation of how organizations develop and acquire 'capacity for change' to rebuild its IT department satisfied all of these criteria.

Site Selection

Since the goal is to understand how an organization develops the 'capacity for change' during the back sourcing process, a case that meets the following requirements is required: (1) the organization has previously outsourced its IT activities, and (2) the organization has since back sourced its IT activities. Back sourcing can range from bringing a single IT service such as helpdesk back into the organization to a large-scale complete back sourcing where an organization rebuilds the entire IT department. The latter is much larger in scale and complex in nature. To capture the complexity of reabsorbing the IT function back into the organization, a case that involved the restructuring of the entire IT department was selected.

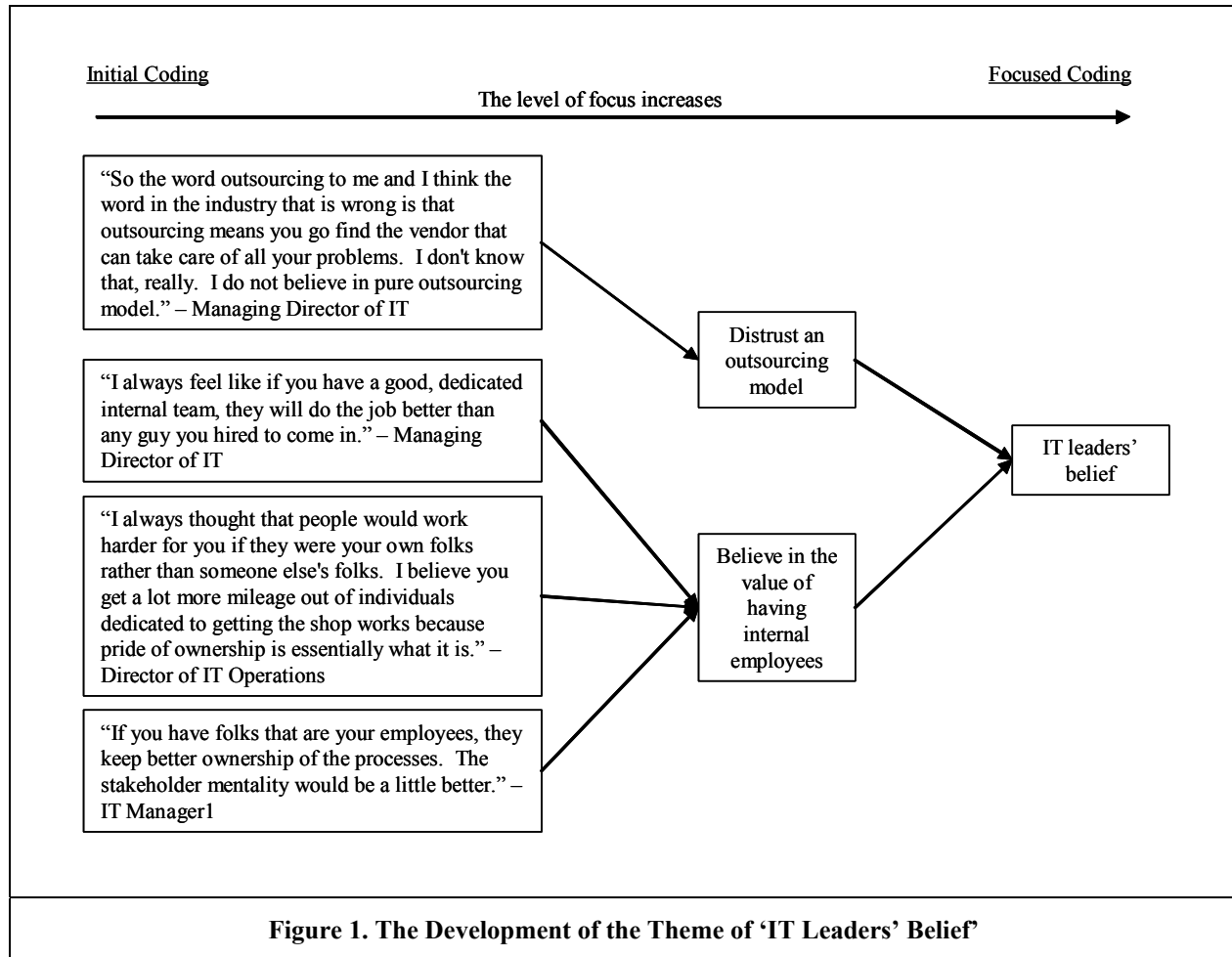
Data Collection and Analysis

Data collection took place in 2004. A total of eleven interviews were conducted with seven personnel from a Fortune 1000 company (i.e., Alpha) (see Table 1). The interviews, in the format of both unstructured and semi-structured, were guided by the dimensions of inquiry described in Table 2. Each dimension was aimed at furthering the understanding of the development of the three aspects of capacity for change. For example, the dimensions of both the 'pre-back sourcing period' and 'transitioning period' provided information on how Alpha developed or acquired the ability to manage the transitioning process. Each interview lasted between 60 to 90 minutes. All interviews were tape-recorded and transcribed.

Table 1. Profiles of Interviewees		
Position	Involvement in the Backsourcing Process	Number of Interviews
Managing Director of IT	Decision Maker	3
Director of IT Operations	Decision Maker	2
IT Manager1	Decision Maker - Previously worked for VENDOR and now for Alpha	2
IT Manager2	Decision Maker - Participated in the backsourcing process	1
IT Specialist1	Previously worked for VENDOR and now for Alpha	1
IT Specialist2	Previously worked for VENDOR and now for Alpha	1
IT Specialist3	Newly hired staff during the backsourcing process	1

Table 2. Dimensions Guiding the Interviewing Process	
Dimension	Description
Drivers of backsourcing	Factors leading to backsourcing. Vendors' performance, internal and external environment changes, organization's structural changes.
Pre-backsourcing period	Backsourcing preparation. Goal setting. Service continuity plan. Organizational acceptance. Contract termination.
Transitioning period	Backsourcing process. The timeline, rationale, approaches, and procedures. Resource and skill acquisition. Backsourcing management process. Change management process.
Post-backsourcing period	Backsourcing outcome. Critical success factors. Operational capabilities. Service continuity plan. Performance measures.

An 'analytic coding' method that shifts iteratively between initial coding and focused coding was employed to analyze the data (Lofland and Lofland 1995). This data analysis strategy mirrors Yin's (1994) pattern-matching and Miles and Huberman's (1994) pattern-coding method. In initial coding, a broad search for any concrete categories that relate to how organizations develop the 'capacity for change' was conducted. Codes were used to organize and classify the categories. These codes are explanatory or inferential codes that function to pull the data together into a more meaningful form (Miles and Huberman 1994). In focused coding, the coding list was narrowed down by identifying and keeping frequently used codes while winnowing out less productive codes. The process of examining the category and refining the codes continued until important themes began to solidify. Figure 1 shows an example of how analytic coding was performed on the data.



Case Background

Alpha is one of the largest service companies headquartered in United States. It has over 10,000 employees located in 3,000 service centers in eleven countries. Alpha grew over the years through acquisitions of smaller organizations around the globe. The strategy worked well. Its financial performance improved and its stock value increased. Its annual revenue in 2005 reached \$2.5 billion. In 1995, Alpha outsourced the entire IT department to VENDOR in a five-year, \$32 million contract. Only two personnel remained in-house. Having essentially no IT skills, these two general IT managers were tasked to coordinate IT activities. One of the contributing reasons to outsourcing was that the IT department was not favorably viewed by top management.

Business users often bypassed the IT department on most decisions. Suggestions from external consultants were implemented without IT involvement. The result was an IT department that was unmanageable, disorganized, and incompetent. Outsourcing to a major vendor then became an attractive solution to the existing problem. By engaging VENDOR, top management hoped to reduce costs and achieve better services and performance. Top management also expected VENDOR to support its global expansion plan.

However, Alpha's expectation of outsourcing was never materialized. Deliverables with respect to the contract were not being met. Additional costs increased sharply. The processes were also plagued with “red tapes” (IT Specialist1). The outsourcing arrangement had left Alpha with “no sense of [information systems] (IS) direction, arcade architectures, silo systems [poor processes], and outdated IS skill sets” (Managing Director of IT). The overall rallying cry in Alpha was: “It was just a dead IT function.”

At the same time (in 1997), Alpha's performance started to decline as the acquisition strategy became expensive. It found itself in a period of severe financial constraints brought by increased competition, governmental regulations, large debt, and high interest rates. This financially weak position led management to restructure its top management team and to consider ways to trim budgets in all areas of business. IT was no exception. In late 1998, Alpha hired the Managing Director of IT, who in turn brought in the entire IT management team with him. It was this new IT team that made the decision to backsource the IT function.

The backourcing process (see Figure 2) was embarked on in the late 1999 and completed after three years. The IT management started with the components that was most problematic yet easier to tackle and moved up the difficulty ladder toward components that were much harder to manage and core to the organization. The Managing Director of IT simulated the process as "peeling the onion" – the strategy of moving from the most problematic area and working toward the core. For each component, Alpha evaluated the cost-benefits of bringing it back in-house versus re-outsourcing to new vendors. Factors taken into consideration included cost, service quality, security, strategic value, and definability of the service-level agreements (SLAs). Based on the evaluations, the majority of the components were backourced while a few were re-outsourced to new vendors. Even though Alpha faced some obstacles along the transitioning process and saw some degradation in service quality right before the actual transitioning process, overall the IS management team considered the backourcing plan a success.

Case Analysis

Alpha's backourcing experience can be dissected using the three aspects of 'capacity for change'. Specifically, for each 'capacity for change', the corresponding strategies Alpha employed are identified. These strategies are effective, as the backourcing effort was considered successful not only from the perspective of IT management but also from the perspectives of top management as well as business units. The result is a more competent IT department, better relationships with business units, and improved IT credibility. The following describes what Alpha did with respect to the three aspects of 'capacity for change'.

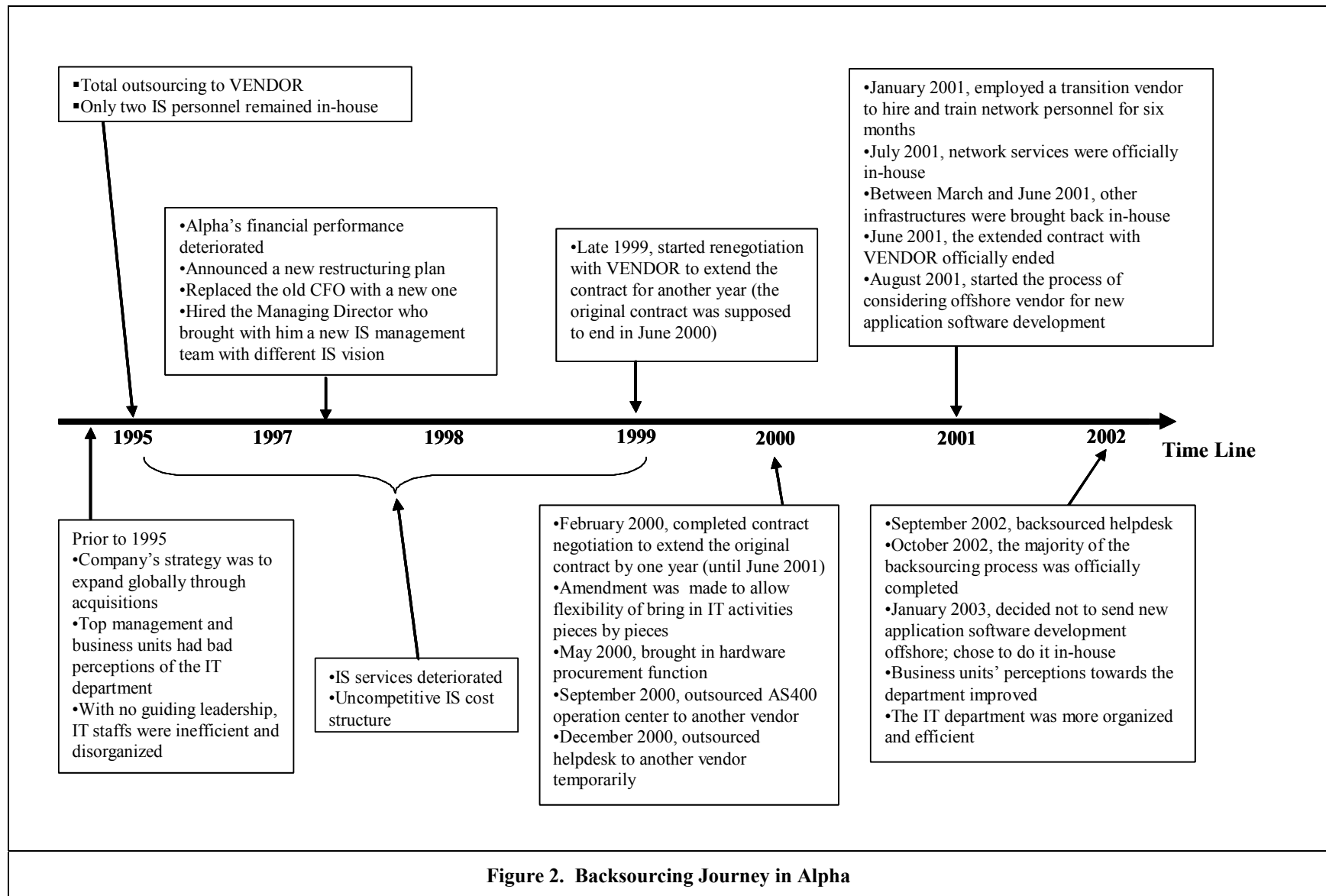
Having Sufficient Understanding of the New Conceptual Destination

Having sufficient understanding of the new conceptual destination is important to ensure the success of a restructuring process (Greenwood and Hinings 1996). It establishes a clear goal on what to achieve and how to achieve the goal. It also keeps organizations on target when facing obstacles. Usually it is the management's vision of the future destination that initiates changes in organization (Boeker 1997; Hitt and Tyler 1991). Their visions/decisions are often shaped by factors such as experiences, knowledge, philosophies, and beliefs (Armstrong and Sambamurthy 1999; Boeker 1997; Hitt and Tyler 1991). In Alpha, the idea of backourcing was conceived by the new IT management team who knew very well what they planned to do and how to achieve the goals. This management understanding, philosophies, and beliefs drove the implementation of the backourcing plan and kept Alpha on focus when facing obstacles.

IT Leaders' Belief

In Alpha, the backourcing initiative was spearheaded by a newly arrived Managing Director of IT who believed in internal IT service model as opposed to an external one. He brought in a team that shared similar philosophies and beliefs. This team believed that internal IT personnel had different psychologies and attitudes toward their jobs. Internal employees were more loyal, had the organization's interest in mind, and had more ownership pride toward the end products. Thus, they were willing to work harder and were more focused on their jobs. These beliefs formed the bases of the backourcing efforts. Even though the process was complicated and took much longer to finish, the team was persistent and focused in their pursuit of the goals. The team also understood and prepared to manage the complexity of shifting to (and operating in) the new environment. Interviews with the IT executive team yielded comments like these:

"So the word outsourcing to me and I think the word in the industry that is wrong is that outsourcing means you go find the vendor that can take care of all your problems. I don't know that, really. I do not believe in pure outsourcing model. In my view, I am yet to see an outsourcing situation that I thought was done better than a well managed IT shop could do for



itself...It [i.e., outsourcing] was a wrong solution to where we were headed. If you were in the AS400 world, and you are moving to another world, and you don't believe this vendor is the right vendor to get you there, why keep the vendor. Why not rearrange your world.” – Managing Director of IT

“If you have folks that are your employees, they keep better ownership of the processes. The stakeholder mentality would be a little better.” – IT Manager1

Establish the Need for Change

The need for change in Alpha was triggered by poor vendor performance. The initial expectation of cost saving, better service quality, and assistance with the expansion plan were never materialized. Not only that, Alpha was left with “no sense of IS direction, arcade architectures, silo systems, [poor processes], and outdated IS skill sets” (Managing Director of IT). VENDOR’s plan also did not support future business strategy in Alpha as commented by the Managing Director of IT:

“VENDOR wasn’t taking us to where we want to go. If you can imagine a company running a \$3+ billion business on AS400 on batch mode in the year 2000, if you consider that is contemporary or state of art, I would be very disappointment at your background. But, that where this company was.”

Having the Ability to Manage How to Get to that Destination

Transitioning the entire IT department from an external vendor into the internal organization is a very complex task. It involves reconfiguration of the structures, processes, people, and infrastructures (Buxbaum 2002; Overby 2003a). To ensure a smooth process, organizations need to acquire the ability to manage the entire process. Alpha acquired this ability using four strategies. First, Alpha garnered the buy-in and support of top management and business units by continually selling the vision of an efficient and effective internal IT department. Second, Alpha extended the contract to ensure continuity of service and to give management enough time to plan the entire back sourcing process. Third, a systematic approach was undertaken to decide the sequence at which outsourced components were brought into the organization. Fourth, unanticipated obstacles that arose during the process were handled carefully and effectively.

Sell the Backsourcing Case

Managing the perceptions and attitudes of key stakeholders affected by the back sourcing plan is a key part of the restructuring process. Even though vendors have performed poorly, the task of convincing top management and business units of the need to move away from existing outsourcing arrangement into having internal IT department remains a challenging job. The effort is often impeded by the original negative perception of the internal IT department (Chapman and Andrade 1998). Such perception is difficult to change even with the presence of new disconfirming evidence (Anderson and Kellam 1992; Anderson and Lindsay 1998). For back sourcing, bringing the IT department back into the organization contradicts the original perceptions and expectations of outsourcing and negates the mantra of industrial trend toward outsourcing (Chapman and Andrade 1998). Top management and business units fear that back sourcing would return them to the original internal IT environment prior to outsourcing. Consequently, they tend to resist attempts to bring the outsourced IT function back in-house.

The IT management in Alpha handled the resistance by continuously selling the vision of having an efficient and internal IT department to top management and business units to garner their support of the back sourcing plan. Constant communication was maintained with business units to keep them update of the process and how the changes would affect them. This helped to alleviate fear and minimize skepticism about having internal IT services again. Furthermore, Alpha was constrained by poor financial performance and rising IT charges from VENDOR. The IT management capitalized on this opportunity to present a business case of an internal IT department that was more cost effective than external vendors.

Besides convincing the top management and business units, the IT management also educated its own personnel of the vision and mission of the new IT organization. This was evident when all interviewees seemed to share the same vision and had the same understanding of the rationale behind back sourcing. They understood where the IT organization was heading and how the restructuring process helped them achieve their goals.

Delay Outsourcing Contract Termination

The IT management team understood the complexity and the scale of bringing the entire IT function back in-house. The back sourcing plan was initiated in the late 1999. However, management realized that it would not have enough time to prepare for the change when the contract terminated in June 2000. Furthermore, the provisioning of the contract did not provide Alpha any room to maneuver until after the termination date. To allow it enough time to prepare and plan for the move, Alpha renegotiated a new contract with VENDOR to extend the original termination date for another year. Flexibility was built into this extended contract to allow Alpha to reabsorb each component at its convenience without affecting the entire contract. Another reason for extending the contract was to ensure the continuity of IT services during the implementation process.

“We extended the contract for a year because we weren't ready to make the move. Couldn't get everything organized when the contract terminated in June 2000. We extended the contract for twelve months, just to give us time to get ourselves organized...We tried to resource the whole [IT] organization, it was very complex.” – Managing Director of IT

“The original contract had everything so tightly web together with one another. For us to migrate away from VENDOR into our own internal department or other outsourcers was extremely difficult. So, when we re-negotiated, we also reorganized the contract in such a way that it was easier for us to say ok, this functional group can be brought out underneath VENDOR either into another party's hand to operate or into Alpha.” – Director of IT Operations

Use the “Peeling the Onion” Approach

The back sourcing process in Alpha was very complex due to its scope. To overcome the problem, Alpha sliced the entire IT function into different phases and employed a layering approach. It began with the component that was perceived to be the most problematic but easier to handle and moved up the difficulty ladder toward those that were much harder to manage and core to the functioning of its operations. For each component, Alpha evaluated the cost-benefits of bringing it back in-house versus re-outsourcing to new vendors. Factors taken into consideration included cost, service quality, security, strategic value, and definability of the service-level agreements (SLAs). When asked about the restructuring process, the Managing Director of IT used the metaphor of “peeling the onion”,

“That is pretty much the way we have done the exercise. We call it [i.e., the restructuring approach] peeling the onion. We took the top layer of the onion which was the worst problem and we took care of it and we peel the next layer and the next layer and the next layer and the next until we reach the core. As we peel this onion, we consider if we could find the people to do this [referring to an IT component]. This (referring to an IT component) is the commodity in the market place, so it is pretty easy find a vendor to do this...It is not that easy to find a vendor who wants to come in and do these range of things there (referring to another IT component), so we insource most of these.”

Learn from Unanticipated Obstacles

Changes in organizations should take into account both the anticipated and unanticipated events that influence the implementation process (Clark 1997; Orlikowski and Hofman 1997). In Alpha's back sourcing journey, two unanticipated events: a flash flood in June 2001 and the terrorist attack on the World Trade Center in New York City on September 11, 2001. The flood damaged some of the infrastructure while the terrorist attack had an indirect impact on IT management's view of security management. Even though both events sidetracked the back sourcing effort for some period, they instilled different perspectives into IT management and IT personnel. The IT

department learned the importance of teamwork and team spirit in solving problems. Furthermore, disaster recovery, which was not on top management's funding plan, became the top of the agenda.

"The flooding kind of forced us to get together real quick. The water didn't get into here, but the basement got flooded, so all our electrical got knocked down. We didn't have electricity, and next door got flooded too, and so were the computer systems. We had the computers up and at least operational by Monday, that next Monday. So we got that up pretty quick, but then tried to get reconnected to all other locations, to the country, and to the world was a challenge. We were having phone meetings every two hours. Everybody, every group was involved in that. Didn't matter who you were, didn't matter you were computer services, didn't matter you were helpdesk, didn't matter you were desktop services, everybody kind of came together quickly. Everybody put their input, which is good... We were out of this building for a month, and we had people relocated down to [another building]. So that was a real good challenge for all of us, for everybody, for the whole IT department. It opened eyes to some of the things we were missing." – IT Specialist2

"[Before the flood,] I couldn't get any budget money to do disaster recovery, because when you go to the management, and you say I want to spend \$150 thousand to have a redundant network, and a redundant hardware, they would say I don't know why you want all that. Well, when the flood came, you don't have much problem explaining it any more. Now, everybody understands disaster recovery." – Managing Director of IT

"Security has become the major issue in our organization after 9/11." – Director of IT Operations

Having the Resources, Skills, and Competencies Required to Function in that New Destination

The need to have necessary resources, skills, and competencies to function once the outsourced IT components are transitioned back into the organization is critical. During the outsourcing arrangement, many organizations transfer part or even all of their IT assets to vendors, leaving them with minimum capability (Buxbaum 2002; Chapman and Andrade 1998). When organizations choose to discontinue their relationships with vendors, they are placed in a vulnerable position. As such, when the decision to backsource is made, organizations need to make sure that they have the means of hiring IT personnel and acquiring infrastructure to ensure continuity of IT services. The Director of IT operations at Alpha emphasized the criticality of the continuity of services by calling it "the biggest hurdle" in its backourcing process. To overcome the problems, Alpha hired the majority of VENDOR's employees and engaged transitional vendors to recruit and train personnel in specific areas. Alpha also adopted a vendor-client service model to communicate progress and demonstrate value to the business units. By doing all these, Alpha made sure that it built the capabilities to function in-house.

Hire Vendor's Employees

To ensure continuity of service, Alpha negotiated with VENDOR to transition the majority of its employees to its internal IT department. Alpha also offered enticing incentives to retain these employees.

"The biggest hurdle was to make sure that the continuity of service was there. We managed that by hiring a lot of VENDOR's staff who's already in the position. About 40% of our network group was from VENDOR, 100% data security group was from VENDOR, about 75% of our server group was from VENDOR. We got quite a number of people to stay with us. So that helped us with the continuity of service." – Director of IT Operations

Engage Transitional Vendor

When it came to the point where Alpha needed to transition the network component, it faced several obstacles. First, no skilled personnel from VENDOR were available. Second, no internal network engineering skills existed to establish the processes and procedures related to the network component. Third, it was difficult to hire and train personnel in the area. Alpha addressed this issue by engaging a 'transitional vendor'. The transitional vendor recruited and trained a pool of new IT personnel in the networking area for six months. Alpha then chose from this

potential employee pool those individuals they were interested in hiring as permanent staff. The transitional vendors also helped to prepare documentation and ensure that the necessary processes and procedures were put in place. By employing this strategy, Alpha avoided the problem of venturing into area it was not familiar with and reduced the effort of hiring and training new IT employees.

“We found the market for those people (i.e., network engineering) very difficult to find. So we went with a vendor that is a transitional vendor. Their *modus operandi* in life is to help you go from an outsourced to an insource situation. They hired the people, they trained the people, and at the end of the six-month period, they transferred them to your organization, which is a little different flavor than anything we have done before. But we did not feel competent to go do that because we had no skill in the network engineering and they did. So that occurred at the end of July 2001. They hired the people, trained them, when we got more or less stable they transferred them to us.” – Managing Director of IT

Manage IT Personnel Turnover

IT personnel turnover is a concern to organizations. When an IT staff person leaves, an organization loses not only the knowledge capital, it also faces the threat of continuity of services. This phenomenon is common during back sourcing, as there are a lot of uncertainties and IT personnel are worried about their future. To minimize the impact of IT personnel turnover, Alpha trained a backup person for each IT position. Should one individual choose to leave, there was always another person who was prepared to take over the responsibility.

“When I first got here, they were having some turnarounds. Some people were leaving the company. They had some people that the company had to let go because of some issues with their work...It’s a lot more structured and stabilized now in terms of the structure, the people, and in terms of aligning people with responsibilities. It is more aligned and more focused from the business perspective.” – IT Manager2

“Everyone has his own little area with a backup person. For example, me, I am in the network security. I have someone that backs up me if I am not here.” – IT Specialist3

Adopt a Vendor-Client Service Model

The IT department adopted a vendor-client relationship model with business units. It understood the importance of instituting metrics to capture performance and progress toward achieving business goals and communicating the progress to business units. Several metrics were developed. Internally dashboards were used to monitor the performance of systems at headquarters and service centers. Externally a survey of user satisfaction was conducted every quarter. At the time of the interview, the IT department was also planning to establish SLAs with business units, which will help create a formal coordination mechanism. If SLAs are implemented, special efforts will be needed to educate business units about the role of SLAs in facilitating responsiveness to the changing business climate and the need to modularize the requirements for different projects to meet the agreements. Through all these measures, the IT department was able to demonstrate value to the business units. Besides that, internal marketing was also used to create awareness of new services among users in business units.

“A survey on how happy the clients are with us. To keep the client happy, no complaints, and every one is moving along without any issues. Customer satisfaction is a big one. The measurement that we have in place to measure the efficiency is how fast the turnaround time. That is also equates back to the contentment of the users. The users want their requests turn around pretty fast. That’s one way to measure it, and also the accuracy of how they set it up. The accuracy is difficult to measure. The time they take to do the job is measured on our side. The survey is on the customer side. The survey goes out every 3 months so we can measure it [i.e., customer satisfaction] quarter by quarter as we move forward.” – Director of IT Operations

“The network services manager has to provide monthly utilization report of the network, and Internet utilization to his boss and it goes up from there...There is also a system to tell you which

frame relay site is down. It can tell you which satellite side is down, which server is down, at which location. We are advertising that to the user community...We are also moving to some kinds of service level agreements. I am not sure what metrics we are going to use, but we have to have a mechanism of measuring reliability...If someone's perception is the network has to be up 100% of the time, if he gets onto the computer in the morning and he can't get on to the Internet, then that's a problem because his perception is it has to be up all the time. If we have a SLA of 99.5% or 100% or 90%, then we can compare the metric." – IT Manager2

Even within the IT department, the concept of vendor-client relationship model applies. The IT department was divided into different teams, such as the network security team, the application development and maintenance team, the server team, and the helpdesk team. Depending on the positioning of the value chain, the team providing the service was considered the vendor while the team receiving the service was treated as clients. These clients were called internal users. The philosophy of "making the customer happy" applied here to ensure that "internal users [were] satisfied with the services" (IT Manager2). In fact, the satisfaction of users within IT was crucial because, according to IT Manager2, "internally IT people have to be satisfied with [our] own services and perceive ourselves as successful before other people [i.e., business units] perceive us as successful."

Discussions and Conclusion

This study aims at understanding how organizations reabsorb the outsourced IT components to rebuild the internal IT department. It focuses on the types of capabilities organizations need to develop and acquire to ensure a successful back sourcing process following a failed outsourcing relationship. Using the concept of 'capacity for change', this study identifies and categorizes different strategies that facilitate the development of 'capacity for change'. These strategies have inherent strengths and values that contribute to successful implementation of a back sourcing plan (see Table 3).

The study identifies a few interesting strategies that are unique to the back sourcing context. One such strategy is the adoption of a vendor-client service model within an organization. Adopting this model requires a mindset change on the part of IT personnel and business users. For the IT personnel, the new mentality should be "business users are our clients. Our philosophy is to make the clients happy." For the business users, the new mentality should be "The IT department is our supplier. We need to follow the procedures established when requesting services." Therefore, every request and every service provided is treated as a business transaction performed based on established SLAs. Different metrics are established to track progress and to measure the performance of the IT department. Issues and results are constantly communicated to business users. Through this service model, the IT department will learn to be more responsive to user needs while business users will have more accountability for the services they requested. This will improve IT credibility in organizations and foster a harmonious working relationship between the IT department and business units. The presence of checks-and-balances will also help to shape a more competent IT department. The vendor-client service model is also valuable within an IT department. The same mentality toward business users can be applied here to ensure that different functions within the IT department work effectively together.

Another interesting strategy is the delaying of the termination of the outsourcing contract. This strategy contrasts with the general perception of how to handle a failed outsourcing relationship. One would think that when outsourcing fails, the best move is to make changes and shift away from the vendors as quickly as possible. This means an immediate termination of the contract. However, the findings show that delaying contract termination actually proves to be a wise move. By doing so, organizations gain time to plan their next move carefully, and to make sure that a sound strategy, not a rush decision, guides the restructuring effort. At the same time, organizations ensure continuity of service while undertaking the restructuring plan.

Engaging transitional vendors to recruit and train IT personnel in specific areas is essential, especially in the fast-changing IT industry where the constant requirement for new skills is the norm. Through transitional vendors, organizations are able to select the best individuals from a pool of qualified personnel. Organizations are also able to reduce the high costs of recruiting and training new personnel. The same practice is a useful recruitment strategy to any organization and within any functional unit.

Overall the research findings highlight the importance of having the three capacities for change in a back sourcing plan. This means organizations have to understand the viability of back sourcing to their business, i.e., how back sourcing fits into the overall IT strategy as well as the business strategy. Organizations also need to develop the

ability to manage the restructuring process. In addition, organizations have to make sure that the necessary resources, skills, and competencies are present so that they will be able to function when back sourcing is completed. The research findings also underscore several useful strategies that contribute to the development of each 'capacity for change'.

The research findings should be carefully interpreted within the context of this study – a single case study of an organization that underwent a total back sourcing process. The scale undertaken in Alpha is extensive and the processes are very complex. As outsourcing practices mature, most organizations are likely to move toward selective outsourcing with multiple vendors. This indirectly reduces the scale and complexity should organizations choose to implement back sourcing. Nonetheless, the key message remains: organizations still need to make sure that they develop and acquire the necessary 'capacity for change' to ensure a successful implementation of IT back sourcing. Other back sourcing cases could thus gain valuable insights from the strategies and aspects of 'capacity for change' identified in this study. The different scale and complexity of back sourcing cases pave avenues for future research to compare and contrast potential differences in strategies adopted under different circumstances. Furthermore, it would be interesting to examine in detail the application of some of the strategies identified in this study. For example, future research could investigate the implementation of a vendor-client service model within an organization. Is this model a viable solution to improve internal IT services and competency? Will the implementation of this model improve user satisfaction? How does this internal vendor-client service model differ from an external vendor-client service model?

This study makes several contributions. First, it investigates an important area that has not been widely addressed. Part of the reason is that organizations are reluctant to publicize their back sourcing decision is that the decision reflects the failure of their previous outsourcing strategy. This often contributes to the underreporting of back sourcing cases (Chapman and Andrade 1998) and the reluctance of organizations to participate in research studies such as the one presented in this paper. However, considering the statistics of organizations willing to pay heavy termination penalties to rebuild internal IT capabilities, back sourcing is an important phenomenon that deserves more attention.

Second, back sourcing is estimated to reach a total of 10% of the outsourcing market annually by 2007/2008 (Davison, et al. 2003). Some have even predicted that the outsourcing pendulum will eventually swing back toward internal provision of IT services (Hirschheim and Lacity 1998; Hirschheim and Lacity 2000). Based on these predictions, the number of organizations attempting back sourcing is apparently on the rise. This means that back sourcing will likely be an important agenda of CIOs today and in the near future. The concern then is how will organizations be successful in their back sourcing efforts? Do they know the type of capabilities that will facilitate the implementation plan? How will they develop these capabilities? This study contributes by identifying the three aspects of 'capacities for change' required to ensure successful back sourcing implementation. It also pinpoints useful strategies needed for organizations to develop and acquire each 'capacity for change'. For those intending to reabsorb their outsourced IT components and rebuild the internal IT department, these strategies could serve as exemplary practices for their back sourcing effort.

Finally, this study applies the concept of 'capacity for change' to the back sourcing context. It identifies different strategies associated with each aspect of 'capacity for change'. By doing so, it contributes practical understanding to the existing knowledge of both back sourcing and 'capacity for change'. It also adds another layer of detail to the original concept introduced by Greenwood and Hinings (1996).

Table 3. Lessons Learned

Aspects of Capacity for Change	Lessons Learned
IT leaders' belief	IT leaders spearhead the direction of the IT department. With a restructuring plan as complex as back sourcing, organizations need leaders who believe in internal service model to initiate and implement the plan, and sustain commitment to the plan.
Establish the need for change	The need for change serves as motivating factors of back sourcing plan. It establishes a sense of urgency and energy toward the plan.
Sell the back sourcing case	Back sourcing requires a mindset change on the part of top management and business users. Since they often have negative perceptions of internal IT department, changing their perceptions should be the first and foremost task. Doing so requires education and demonstration of the capabilities of internal IT department as well as the values of back sourcing.
Delay outsourcing contract termination	Careful planning of a back sourcing decision is critical. A failed outsourcing relationship is frustrating and dispiriting. However, by not rushing to terminate the contract without the presence of an alternative good plan, organizations ensure continuity of services and prevent existing problems from worsening. At the same time, organizations also gain time to evaluate its readiness in executing the back sourcing plan. Only when organizations feel they have the capabilities to undertake an enormous and challenging task as rebuilding the entire IT department, should they proceed with the back sourcing plan.
Use the "peeling the onion" approach	A systematic approach helps to structure the complex task of transitioning outsourced IT components back in-house and rebuild the entire IT department.
Learn from unanticipated obstacles	Unanticipated obstacles open eyes to things that organizations would otherwise never emphasize on. Valuable experience is earned from managing and solving these unanticipated problems.
Hire vendor's employees	Continuity of IT service is critical to organizations at any point in time. To ensure enough skilled IT personnel are present to service users, organizations could combine different strategies. For example, organizations could hire vendor's employees, employ new personnel on their own or engage a transitional vendor to recruit qualified individuals. Since individuals react differently to back sourcing plan, organizations have to accommodate individual concerns to reduce turnover rate.
Engage transitional vendor	
Manage IT personnel turnover	
Adopt a vendor-client service model	A vendor-client service model creates the mentality of the need to "make customers happy." The mentality drives service strategy and direction of the IT department. Adoption of the model also requires identification of metrics, tracking of progress, and communication of results to business users. Through this model, the IT department will learn to be more responsive to user needs while business units will have more accountability of the services they requested. This will improve IT credibility in organizations and foster a harmonious working relationship between IT department and business units.

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